

Discussion of the History of Colombia

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David Perez-Reyna and Daniel Osorio-Rodríguez present an interesting description of the monetary and fiscal policies of Colombia since 1960. Their characterization of those almost six decades during three distinct periods—one of fiscal dominance with low inflation, a second one of fiscal dominance with higher inflation, and a third one of monetary dominance—seems accurate and uncontroversial.

The discussion presented in the chapter could be complemented along two fronts. First, because of their focus on central government finances, the authors understate the role of fiscal (or quasi-fiscal) matters in the rise and stabilization at moderate levels of inflation during their second period of analysis (1971–90). While the explanations provided by Perez-Reyna and Osorio-Rodríguez are accurate, the authors themselves question why, given a not-so-large increase in the fiscal deficit, inflation rises so much and continues in the 20 to 30 percent range. Part of the explanation comes from several institutional arrangements existing in Colombia that substituted for fiscal policies (with monetary implications), which are not captured in central government—or in some cases, any—fiscal data.

Two examples are the government substitute functions of the National Coffee Fund, a government fund managed by the private sector (National Federation of Coffee Growers), and the mechanisms developed in the financial sector and the central bank to foster home ownership. Through different mechanisms, which did not have a direct counterpart in the central government's fiscal accounts, expansionary fiscal policies that were financed through money issuance were carried out during several years of the second period of analysis. This happened thanks to the governance of monetary policy since the mid-1960s and up to the early 1990s. Beginning in 1963, the Junta Monetaria, the entity guiding monetary policy, was composed of the minister of finance, the minister of development (who led the housing initiatives), the minister of agriculture (recall that the major export was coffee), the chief of the National Planning Department, and the general manager of the central bank. In 1976, the director of the main government trade agency, INCOMEX (Instituto Colombiano de Comercio Exterior), was added to the junta. Without vote were the economic secretary of the president's office, the banking superintendent, and two technical advisers to the manager of the

central bank. By design, the most important lobbies of the country made up part of the governing body of monetary policy. This arrangement had important consequences for how several sectors—particularly the coffee and the housing sectors—benefited from, at times, expansionary monetary policies.

As the authors discuss, coffee was the major export of Colombia throughout a significant part of the period analyzed. During many years, the expenditure of the National Coffee Fund, whose revenue was a tax on coffee exports, substituted for that of the government in many areas of the country. The Coffee Fund paid for the construction of infrastructure and provided various social security services in many areas of the country. To keep its levels of expenditure, the fund relied on the central bank's exchange rate management and its monetary consequences. For example, when the price of coffee rose and commodity revenue in foreign currency inflows increased, they were monetized by the central bank to avoid a currency appreciation and allow an increase in the fund's expenditure. With the bonanza of 1975–77, this mechanism led to inflationary pressures that later were perpetuated again through other indexation mechanisms. From this perspective, the expenditure of the Coffee Fund was inflationary, not because the central bank was lending to the public sector, but via the protection of the exchange rate and Decree 444 of 1967 (exchange rate regulation), which was designed with the coffee growers in mind.

In the early 1970s, the interests of the coffee sector were explicitly represented in the Junta Monetaria. But they were not the only major lobby that had a seat on the Junta. The interests of different parties supporting the development of a housing market (one of the key drivers of the National Development Plan of 1970–74—dubbed “the Four Strategies”), the minister of development, and the chief of the National Planning Department also sat on the Junta and had a say in the design of a potentially inflationary mechanism to develop mortgages. The view of the National Development Plan, inspired by Lauchlin Currie, a North American economist advising the government, was that housing shortages could be addressed by developing long-term mortgages. Given the risks associated with volatile interest rates and maturity risks because of the short terms of any savings instrument, developing mortgages would require some policy intervention.

The solution designed at the time was to index mortgages to inflation and have them supplied by financial intermediaries that could issue deposits in inflation-indexed units. So economic authorities created the Corporaciones de Ahorro y Vivienda—CAVs (savings and loans entities). The CAVs had no currency risk, since they issued deposits and loans in the same currency (inflation-indexed units [UPAC, Unidad de Poder Adquisitivo]), but they were still exposed to maturity risks coming from mismatches between the primarily overnight term of deposits and the longer terms of mortgage loans. This risk was dealt with through a convoluted arrangement with the central bank. The FAVI (Fondo de Ahorro y Vivienda), a fund to provide liquidity support to CAVs at the central bank, was created. This became an automatic facility through which CAVs could mitigate the risks of transforming short-term deposits, which competed with interest-rate-paying deposits at any other financial institution, into long-term inflation-indexed loans. When inflation was lower than interest rates, deposits in CAVs would

fall and migrate to the rest of the financial system, causing liquidity problems in CAVs. At that point, the CAVs went to the FAVI, which compensated the fall in deposits via money issuance, which in turn would reduce interest rates and raise inflation until the CAVs deposits recovered. The opposite would happen when inflation was high. CAVs would have excess liquidity, which they would take to the FAVI, a monetary contraction would take place, inflation would fall, and interest rates would rise.

In the 1970s, because of the coffee boom, the interests of coffee growers represented in the Junta led to a monetary expansion and inflation. When the boom was over and the debt crisis hit in the early 1980s and interest rates rose, a monetary expansion through the FAVI took place to compensate the CAVs, in addition to a monetary-based rescue of the rest of the banking system, as mentioned by the authors.

Given the many interests prevailing in the governance of monetary policy, sector-specific shocks that in a way led to quasi-fiscal actions, and that would be reflected in a more comprehensive measure of the fiscal deficit, had overall inflationary consequences. These are not captured in any central government data. In addition, as noted by Carrasquilla (1999) in analyzing moderate inflation in Colombia, several indexation mechanisms were developed, which helped perpetuate any inflationary shock. Colombia ended up having a very convoluted policy framework incorporating several automatic mechanisms that conditioned monetary policy to fiscal (quasi-fiscal) pressure and that contributed to a rise in inflation during most of the 1970s and 1980s.

Interestingly, despite these mechanisms, inflation remained at moderate levels, in part because of the role of the advisers to the Junta. These advisers were usually very technically oriented central bank career economists, with a conservative view of monetary policy that designed instruments to keep inflation in line and counteract the expansionary mechanisms embedded in policy. The use of reserve requirements briefly discussed in the chapter is an example of one of these instruments.

The second complementary discussion to that of the authors, and one that is highly relevant in the recent history of Colombia's fiscal policy, pertains to the role played by the 1991 constitution in the fiscal deficit. The chapter explains in enough detail how the 1991 political constitution allowed for an independent central bank and documents how that relevant change led to a reduction in inflation. However, the chapter falls short in explaining the dynamics of the fiscal deficit during that period and deals only tangentially with how the same notorious institutional change that proclaimed the independence of the central bank also explains the large rise in the fiscal deficit.

The 1991 constitution imposed many mandates on the Colombian government without matching them to income generation. Several authors have documented the fiscal costs of many constitutional mandates regarding pension payments, provision of health services, wage indexation, provision of affordable housing, and subsidized mortgages, among others. While on the one hand, the constitution bought monetary stability, the fiscal cost was, however, substantial.

Overall, this chapter helps order the discussion and complements the existing literature well. Readers interested in inflation dynamics in the 1970s, 1980s, and early 1990s; the political economy during the reforms of the monetary system; other reforms of the

1990s, including the 1991 constitution; and the fiscal costs of the constitutional mandates would benefit from a reading of the references that follow.

References

Carrasquilla, Alberto. 1999. *Estabilidad y gradualismo: Ensayos sobre economía colombiana*. Bogotá: TM Editores.